

Message Text

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SS-20 STR-08 CEA-02 DODE-00 PA-04 USIA-15 PRS-01

AGR-20 L-03 FEA-02 DRC-01 H-03 /200 W

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R 081055Z MAR 74

FM AMEMBASSY LONDON

TO SECSTATE WASHDC 8526

INFO AMEMBASSY BONN

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AMEMBASSY COPENHAGEN

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DEPARTMENT PASS TREASURY AND FRB

E.O. 11652:N/A

TAGS: ECON, UK

SUBJECT: INITIAL ECONOMIC IMPLICATIONS OF LABOR VICTORY

BEGIN SUMMARY: THE NEW MINORITY LABOR GOVERNMENT'S
ECONOMIC POLICY IS NOT YET CLEAR. IT IS APPARENT,
HOWEVER, THAT IN ITS MINORITY POSITION, THE NEW GOVERN-
MENT WILL ONLY BE ABLE TO IMPLEMENT ITS LEAST CONTROVER-
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SIAL ECONOMIC MEASURES WITH A RELATIVELY SURE CHANCE OF

SUCCESS. A KEY QUESTION IN THE SHORT-TERM IS WHETHER THE NEW GOVERNMENT WILL OPT FOR FURTHER DEFLATION OF DEMAND OR FOR A MORE NEUTRAL BUDGET. WE MAY HAVE TO WAIT UNTIL THE BUDGET IS PRESENTED (PROBABLY THE LAST WEEK IN MARCH) TO KNOW WHICH OPTION THE NEW GOVERNMENT HAS CHOSEN.
END SUMMARY

1. THE LABOR PARTY PROMISED A LONG LIST OF SOCIAL/ECONOMIC MEASURES IN ITS ELECTION MANIFESTO. IT PROPOSED, INTER ALIA, PAYING THE MINERS MORE, REPEAL OF THE INDUSTRIAL RELATIONS ACT, INCREASING PENSIONS, GIVING THE PRICE COMMISSION MORE POWER AND ESTABLISHING MAXIMUM FAIR PRICES IN A NUMBER OF BASIC CONSUMER ITEMS, PUBLIC OWNERSHIP OF ALL DEVELOPMENT LAND, INCREASED HOUSE BUILDING SUBSIDIES, REDUCTION OF COUNCIL HOUSE RENTS, ENACTMENT OF A WEALTH TAX, A MORE EFFECTIVE ECONOMIC PLANNING AGENCY, ABOLITION OF DRUG PRESCRIPTION CHARGES, AND A NATIONAL SCHEME OF NURSING SCHOOLS. WE WOULD NOT EXPECT IMPLEMENTATION OF THE MOST CONTROVERSIAL OF THESE BY THIS MINORITY GOVERNMENT. IT IS LIKELY IT WILL CONCENTRATE INITIALLY ON THE ECONOMIC CRISIS, AND PERHAPS A FEW OF THE SOCIAL MEASURES TO PLEASE THEIR LEFT WING AND THE ELECTORATE, WITH AN EYE TO THE NEXT ELECTION.

2. AMONG THE THINGS WE CONSIDER MOST LIKELY FOR THE NEW GOVERNMENT TO TRY TO ENACT ARE AN INCREASE IN PENSIONS, FOOD SUBSIDIES, AND A RISE IN FAMILY ALLOWANCES. HOW THESE WILL BE FINANCED WILL, OF COURSE, DETERMINE THEIR IMPACT ON THE ECONOMY. AMONG FINANCING MEASURES MOST LIKELY ARE A SPECIAL CAPITAL GAINS TAX ON PROPERTY SPECULATORS, AN INCREASED TAX ON GASOLINE, AND AN INCREASE IN VAT ON LUXURY ITEMS. CERTAINLY MANY OF THE TAX REDUCTIONS OF THE PREVIOUS GOVERNMENT WILL BE RESCINDED, BUT WHETHER THESE WILL BE OFFSET BY INCREASED SPENDING ON SOCIAL SERVICES OR TAX REDUCTION IN LOWER INCOME BRACKETS IS NOT KNOWN.

3. AN IMMEDIATE QUESTION IS THE NEW GOVERNMENT'S THINKING ON DEMAND MANAGEMENT. THE NEW CHANCELLOR OF THE EXCHEQUER DENIS HEALEY, HAS BEEN A MAIN AND LEADING SPOKESMAN FOR LIMITED OFFICIAL USE

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AN AUSTERITY PROGRAM, BELIEVING THAT DEMAND NEEDS FURTHER DAMPENING BECAUSE OF THE ENERGY CONSTRAINTS ON OUTPUT AND THE EFFECTS OF THE OUTPUT SHORTFALL RESULTING FROM THE POWER LIMITS ON INDUSTRY. PROPONENTS OF A NEUTRAL BUDGET ARGUE THAT THE PUBLIC EXPENDITURE CUTS OF DECEMBER 17, AND THE INCREASED OIL PRICES WILL DAMPEN DEMAND SUFFICIENTLY TO AVOID EXCESS DEMAND AND EXACERBATED INFLATIONARY TENDENCIES. THERE IS AN ACKNOWLEDGED NEED BY ALL TO

CHANNEL RESOURCES INTO EXPORTS BY CUTTING CONSUMPTION.
THIS WOULD ALSO DECREASE IMPORTS. BUT THE CHOICE WILL
BE BETWEEN CUTTING AGGREGATE DEMAND OR MAINTAINING CURRENT
DEMAND LEVELS BUT SHIFTING EMPHASIS BY CUTTING CONSUMP-
TION AND LETTING EXPORTS AND INVESTMENT (AIDED BY TAX/
SUBSIDY MEASURES) LEAD GROWTH.

4. ANOTHER CRUCIAL QUESTION IS THE TIME NECESSARY FOR THE
ECONOMY TO RETURN TO ITS NORMAL OUTPUT GROWTH TRENDS, NOW
THAT THE MINERS' STRIKE HAS ENDED. POWER TO INDUSTRY HAS
BEEN LIMITED TO 60 PERCENT OF NORMAL SINCE MID-DECEMBER
AND OUTPUT HAS BEEN RUNNING 70-80 PERCENT OF NORMAL FOR
13 WEEKS, BUT THE SHORTAGE OF INPUTS HAS BECOME INCREAS-
INGLY SERIOUS. THUS, THERE WILL BE A PERIOD WHEN OUTPUT

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WILL REMAIN BELOW NORMAL WHILE THESE INPUT SUPPLY CONSTRAINTS ARE WORKED OFF. MOREOVER, THE CASH-FLOW POSITION OF MANY COMPANIES IS POOR AFTER A LONG PERIOD OF PRODUCTION SHORTFALL, AND THIS WILL BE A FACTOR IN SLOWING THE RECOVERY. MANY COMPANIES WILL NOT BE ABLE TO RESUME FULL PRODUCTION FOR SEVERAL WEEKS AFTER FULL POWER IS RESTORED. THUS, IT IS OUR OPINION THAT MUCH OF THE SECOND QUARTER WILL BE A MAKE-UP PERIOD.
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5. THE NEW GOVERNMENT'S POLICY ON INFLATION IS NOT FULLY CLEAR; FOR THE LONGER TERM, THEY HAVE PROMISED STRICT PRICE CONTROL, BUT NO WAGE CONTROLS (LEAVING THIS TO A "SOCIAL CONTRACT" BETWEEN THE PARTY AND THE UNIONS). MANY GROUPS SETTLED UNDER STAGE 3 GUIDELINES, BUT THE LARGE INCREASE IN MINERS' PAY BREAKING STAGE 3 LIMITS, PLUS IMPETUS TO INFLATION RATES OF ELECTRICITY COSTS WHICH MAY RISE BY 40 PERCENT, COULD BRING ESCALATED PAY CLAIMS FROM OTHER LARGE UNIONS. THE GOVERNMENT PROMISED TO KEEP A STRICT WATCH ON PRICES, ESPECIALLY FOOD PRICES, BUT HAS HEDGED ON HOW MUCH THE PRICE RISES CAN REALLY BE INHIBITED. IN PART, IT WILL PROBABLY OFFSET FOOD PRICE INCREASES THROUGH SELECTIVE FOOD SUBSIDIES, INCLUDING A 500 MILLION POUND SUBSIDY PROGRAM MENTIONED BY SHIRLEY WILLIAMS, THE NEW MINISTER FOR PRICE AND CONSUMER AFFAIRS.

6. CONNECTED WITH DOMESTIC ECONOMIC POLICY IS THE NEED TO BORROW INTERNATIONALLY TO OFFSET AT LEAST PART OF THE TRADE DEFICIT. ONE CONSIDERATION IS TO WHAT DEGREE LONG-TERM INTERNATIONAL BORROWING SHOULD BE USED TO FINANCE THE NON-OIL PART OF THE DEFICIT OVER 1974, AND HOW MUCH OF THE DEFICIT SHOULD BE RECTIFIED THROUGH STRINGENT DEMAND DEFLATION, CHANNELING RESOURCES TO EXPORTS AND LIMITING IMPORTS, RELYING ON A COMPETITIVE EXCHANGE RATE. IN FACT, RISING DOMESTIC PRICES MIGHT HELP IMPROVE THE TERMS OF TRADE. OFFSETTING THIS IS THE LOSS OF EXPORT MARKETS RESULTING FROM THE LENGTHY PART-TIME WORKING SITUATION. THE REPUTATION OF UK EXPORTS FOR SERVICE AND DELIVERY - ALREADY POOR IN MANY AREAS - HAS SUFFERED FURTHER. WE HEAR STORIES FROM UK BUSINESSMEN OF THE INCREASINGLY POOR REPUTATION OF THE UK AS A SUPPLIER. THE NEW GOVERNMENT

WILL NEED TO WORK HARD TO OFFSET AND REDRESS THIS
SITUATION.

7. LEAVING ASIDE THE AIM OF NATIONALIZING NORTH SEA OIL,
BASED ON PAST STATEMENTS LABOR'S INTENTIONS ARE ALSO TO
STUDY THE POSSIBILITY OF GREATER GOVERNMENT CONTROL OF
BANKS, INSURANCE COMPANIES, STOCK AND COMMODITY EXCHANGES,
AND TO MAKE MULTINATIONAL COMPANIES OPERATING IN THE UK
MORE ACCOUNTABLE FOR THEIR ACTIONS. WHAT THIS MEANS IN
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PRACTICE, GIVEN LABOR'S MINORITY POSITION IN PARLIAMENT,
IS PROBLEMATIC, IT WILL, HOWEVER, REMAIN A CLOUD OVER THE
CITY. IN ITS DRAFT POLICY PROGRAM DRAWN UP LAST YEAR
(SEE LONDON A-794, JUNE 18, 1973), LABOR SAID IT WOULD
NOT DISTORT THE ECONOMY IN ORDER TO MAINTAIN AN UNREALIS-
TIC EXCHANGE RATE. IT WOULD BE READY TO MOVE THE EXCHANGE
RATE IN EITHER DIRECTION WHEN THE OCCASION DEMANDS.
EXPORTS WOULD NEED TO REMAIN COMPETITIVE. THE EMBASSY
CONCLUDES THERE IS NO SHORT-TERM DESIRE ON THE PART OF
LABOR TO END THE STERLING FLOAT.

8. ALTHOUGH IT IS TOO EARLY TO TELL HOW THE NEW GOVERNMENT
WILL APPROACH THE EC, ITS PAST STATEMENTS HAVE BEEN THAT
THE TYPE OF MONETARY-ECONOMIC UNION FAVORED BY THE EC AND

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CONSERVATIVE GOVERNMENT WAS COMPLETELY OUT OF THE QUESTION FOR ANY BRITISH GOVERNMENT SERIOUSLY COMMITTED TO GROWTH. IT ALSO FELT THAT THE IDEA OF FREE INTERNATIONAL MOVEMENT OF CAPITAL BEING ESSENTIAL TO A LIBERAL WORLD TRADING SYSTEM WAS A DISCREDITED NOTION OF THE PAST. HOW THESE VIEWS WILL INTERFACE WITH THE UK'S OWN NEED TO BORROW INTERNATIONALLY REMAINS TO BE SEEN.

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9. LOOKING AT PERSONALITIES, CHANCELLOR HEALEY MAY NOT BE THE ONLY FIGURE IN THE GOVERNMENT ADVISING ON ECONOMIC POLICY. PRIME MINISTER WILSON WILL HAVE THOUGHTS OF HIS OWN, AND HAS NAMED HAROLD LEVER TO BE CHANCELLOR OF THE DUCHY OF LANCASTER. LEVER WILL HAVE THE PRIMARY FUNCTION OF ACTING AS PERSONAL ADVISER TO WILSON ON ECONOMIC AND FINANCIAL MATTERS. LEVER IS A MODERATE, RESPECTED FIGURE IN ECONOMIC CIRCLES; HIS VIEWS WERE GIVEN IN A PRE-ELECTION INTERVIEW IN WHICH HE ADVOCATED A NEUTRAL BUDGET WITH NO NET REDUCTION IN DEMAND (WITH A REDISTRIBUTED TAX BURDEN), BORROWING ABROAD TO COVER THE FULL CURRENT ACCOUNT DEFICIT, AND WORKING TOWARDS A RETURN TO FIXED PARITIES. SEVERAL LEFT OF CENTER ACADEMIC ECONOMISTS, POSNER, NIELD, AND GODLEY, WHO HAVE RECENTLY PUBLICLY ADVOCATED A NEUTRAL BUDGET MAY ALSO BE CALLED ON BY HEALEY FOR ECONOMIC ADVICE, PERHAPS FORMING A BRAIN TRUST BUT IT IS TOO SOON TO TELL, SINCE OTHER SENIOR TREASURY MINISTERS

(I.E. MP'S EDMOND DELL, JOEL BARNETT, AND JOHN GILBERT)
HAVE JUST BEEN NAMED.

10. THE FIRST OFFICIAL INDICATION WE WILL HAVE OF HOW
HARD THE LABOR GOVERNMENT INTENDS TO PUSH ITS POLICIES
WILL COME NEXT WEEK, DURING THE QUEEN'S SPEECH ON MARCH
12.

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Draft Date: 08 MAR 1974
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Disposition Authority: golinofr
Disposition Case Number: n/a
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Disposition Date: 28 MAY 2004
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Film Number: n/a
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